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BRENDA BURNS

ARIZONA CORPORATION COMMISSION  
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IN THE MATTER OF THE APPLICATION OF  
ARIZONA PUBLIC SERVICE COMPANY FOR  
A HEARING TO DETERMINE THE FAIR  
VALUE OF THE UTILITY PROPERTY OF  
THE COMPANY FOR RATEMAKING  
PURPOSES, TO FIX A JUST AND  
REASONABLE RATE OF RETURN  
THEREON, TO APPROVE RATE SCHEDULES  
DESIGNED TO DEVELOP SUCH RETURN

Docket No. E-01345A-11-0224

**NOTICE OF FILING  
RESPONSE TESTIMONY  
(SETTLEMENT  
AGREEMENT) OF KEVIN C.  
HIGGINS ON BEHALF OF  
FREEPORT-MCMORAN  
COPPER & GOLD INC.  
AND ARIZONANS FOR  
ELECTRIC CHOICE AND  
COMPETITION**

Freeport-McMoRan Copper & Gold Inc. and Arizonans for Electric Choice and  
Competition (collectively "AECC"), hereby submit the Response Testimony (Settlement  
Agreement) of Kevin C. Higgins on behalf of AECC in the above captioned Docket.

RESPECTFULLY SUBMITTED this 25<sup>th</sup> day of January 2012.

FENNEMORE CRAIG, P.C.

By  
C. Webb Crockett  
Patrick J. Black  
3003 N. Central Avenue, Ste. 2600  
Phoenix, AZ 85012-2913

Attorneys for Freeport-McMoRan Copper & Gold Inc.  
and Arizonans for Electric Choice and Competition

1 **ORIGINAL** and **13 COPIES** of the foregoing  
2 **FILED** this 25<sup>th</sup> day of January 2012 with:

3 Docket Control  
4 ARIZONA CORPORATION COMMISSION  
5 1200 West Washington  
6 Phoenix, Arizona 85007

7 **COPY** of the foregoing was **HAND-DELIVERED/**  
8 **MAILED/EMAILED** this 25<sup>th</sup> day of January 2012 to:

9 Lyn Farmer  
10 Chief Administrative Law Judge  
11 Hearing Division  
12 Arizona Corporation Commission  
13 1200 West Washington  
14 Phoenix, Arizona 85007

15 Janice Alward, Chief Counsel  
16 Legal Division  
17 Arizona Corporation Commission  
18 1200 West Washington Street  
19 Phoenix, Arizona 85007

20 Steve M. Olea, Director  
21 Utilities Division  
22 Arizona Corporation Commission  
23 1200 West Washington Street  
24 Phoenix, Arizona 85007

25 Meghan H. Grabel  
26 Thomas L. Mumaw  
PINNACLE WEST CAPITAL  
CORPORATION  
400 North 5<sup>th</sup> Street  
P.O. Box 53999, Ms 8695  
Phoenix Arizona 85072-3999  
Attorneys for Arizona Public Service  
Company

Daniel W. Pozefksy  
RUCO  
1110 W. Washington St., Suite 220  
Phoenix, AZ 85007

Michael A. Curtis  
William P. Sullivan  
Melissa A. Parham  
CURTIS, GOODWIN, SULLIVAN,  
UDALL & SCHWAB, P.L.C.  
501 E. Thomas Road  
Phoenix, Arizona 85012  
Attorneys for Town of Wickenburg

Timothy M. Hogan  
ARIZONA CENTER FOR LAW  
IN THE PUBLIC INTEREST  
202 E. McDowell Rd., Suite 153  
Phoenix, Arizona 85004  
Attorneys for WRA, SWEEP,  
ASBA/AASBO

David Berry  
WESTERN RESOURCE ADVOCATES  
PO Box 1064  
Scottsdale, Arizona 85252

Barbara Wyllie-Pecora  
14410 West Gunsight Drive  
Sun City West, Arizona 85375

Kurt J. Boehm  
BOEHM, KURTZ & LOWRY  
36 East Seventh Street, Suite 1510  
Cincinnati, Ohio 45202  
Attorneys for The Kroger Co.

John William Moore, Jr.  
7321 North 16<sup>th</sup> Street  
Phoenix, Arizona 85020

1 Jeffrey W. Crockett  
BROWNSTEIN HYATT FARBER  
2 SCHRECK LLP  
40 North Central Avenue, 14<sup>th</sup> Floor  
3 Phoenix, Arizona 85004  
Attorneys for Arizona Association of  
4 Realtors

5 Michael W. Patten  
ROSHKA DEWULF & PATTEN, PLC  
6 One Arizona Center  
400 East Van Buren Street, Suite 800  
7 Phoenix, Arizona 85004  
Attorneys for Tucson Electric Power  
8 Company

9 Bradley S. Carroll  
TUCSON ELECTRIC POWER  
10 COMPANY  
One South Church Avenue, Suite UE 201  
11 Tucson, Arizona 85701

12 Cynthia Zwick  
1940 East Luke Avenue  
13 Phoenix, Arizona 85016

14 Michael M. Grant  
GALLAGHER & KENNEDY, PA  
15 2575 E. Camelback Road  
Phoenix, Arizona 85016  
16 Attorneys for AIC

17 Gary Yaquinto  
ARIZONA INVESTMENT COUNCIL  
18 2100 N. Central Avenue, Suite 210  
Phoenix, Arizona 85004

19 Karen S. White  
20 AIR FORCE UTILITY LAW FIELD  
SUPPORT CENTER  
21 AFLOA/JACL-ULFSC  
149 Barnes Drive  
22 Tyndall AFB, Florida 32403

23 Greg Patterson  
MUNGER CHADWICK  
24 2390 E. Camelback Road, Suite 240  
Phoenix, Arizona 85016  
25 Attorneys for Arizona Competitive  
Power Alliance  
26

Nicholas J. Enoch  
Jarrett J. Haskovec  
LUBIN & ENOCH, PC  
349 N. Fourth Avenue  
Phoenix, Arizona 85003  
Attorneys for IBEW Locals 387, 640 &  
769

Lawrence V. Robertson, Jr.  
PO Box 1448  
Tubac, Arizona 85646  
Attorney for Southwestern Power Group  
II, LLC; Bowie Power Station, LLC;  
Noble Americas Energy Solutions LLC;  
Constellation NewEnergy, Inc.; Direct  
Energy, LLC and Shell Energy North  
America (US), LP

Laura E. Sanchez  
NATURAL RESOURCES DEFENSE  
COUNCIL  
PO Box 287  
Albuquerque, New Mexico 87103

Jay I. Moyes  
Steve Wene  
MOYES SELLERS & HENDRICKS  
1850 N. Central Avenue, Suite 1100  
Phoenix, Arizona 85004  
Attorneys for AzAg Group

Jeffrey J. Woner  
K.R. SALINE & ASSOC., PLC  
160 N. Pasadena, Suite 101  
Mesa, Arizona 85201

Scott S. Wakefield  
RIDENOUR, HIENTON & LEWIS,  
PLLC  
201 N. Central Avenue, Suite 3300  
Phoenix, Arizona 85004  
Attorneys for Wal-Mart Stores, Inc.

Steve W. Chriss  
Wal-Mart Stores, Inc.  
2011 S.E. 10th Street  
Bentonville, Arkansas 72716

1 Mel Bear  
2 4108 West Calle Lejos  
3 Glendale, Arizona 85310

3 Craig A. Marks  
4 CRAIG A. MARKS, PLC  
5 10645 N. Tatum Boulevard  
6 Suite 200-676  
7 Phoenix, Arizona 85028  
8 Attorney for AARP

Douglas V. Fant  
LAW OFFICES OF DOUBLAS V.  
FANT  
3655 W. Anthem Way  
Suite A-109, PMB 411  
Anthem, Arizona 85086

Amanda Ormond  
INTERWEST ENERGY ALLIANCE  
76630 S. McClintock Drive  
Suite 103-282  
Tempe, Arizona 85284

9 By: 

10 6647560

**BEFORE THE ARIZONA CORPORATION COMMISSION**

In the Matter of the Application of Arizona )  
Public Service Company for a Hearing to )  
Determine the Fair Value of the Utility )  
Property of the Company for Ratemaking )  
Purposes, to Fix a Just and Reasonable )  
Rate of Return Thereon, to Approve Rate )  
Schedules Designed to Develop Such Return)

Docket No. E-01345A-11-0224

**Responsive Testimony of Kevin C. Higgins**

**on behalf of**

**Freeport-McMoRan Copper & Gold Inc. and  
Arizonans for Electric Choice & Competition**

**Settlement Agreement**

**January 25, 2012**

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**RESPONSIVE TESTIMONY OF KEVIN C. HIGGINS**  
**SETTLEMENT AGREEMENT**

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2                   **SETTLEMENT AGREEMENT**

3

4           **INTRODUCTION**

5           **Q.     Please state your name and business address.**

6           A.           Kevin C. Higgins, 215 South State Street, Suite 200, Salt Lake City, Utah,  
7                       84111.

8           **Q.     Are you the same Kevin C. Higgins who previously filed direct testimony in**  
9                       **support of the Settlement Agreement in the Arizona Public Service Company**  
10                   **("APS") general rate case on behalf of Freeport-McMoRan Copper & Gold**  
11                   **Inc. and Arizonans for Electric Choice and Competition (collectively**  
12                   **"AECC"), and also filed direct testimony on the topics of revenue**  
13                   **requirement and cost of service/rate design in this proceeding?**

14          A.           Yes, I am. I described my qualifications in my revenue requirements  
15                       testimony. A more detailed description of my qualifications is contained in  
16                       Appendix A, attached to that testimony.

17

18           **OVERVIEW AND CONCLUSIONS**

19          **Q.     What is the purpose of your responsive testimony in this phase of the**  
20                       **proceeding?**

21          A.           I am responding to the testimonies in partial opposition to the proposed  
22                       Settlement Agreement ("Agreement") submitted by Ralph Cavanagh on behalf of  
23                       the Natural Resources Defense Council and Jeff Schlegel on behalf the Southwest  
24                       Energy Efficiency Project.

1    **Q.     Please summarize your responsive testimony.**

2    A.           I recommend that the Commission reject each of the proposed changes to  
3           the Settlement Agreement advocated by Mr. Cavanagh and Mr. Schlegel. In  
4           particular, I recommend that the Commission reject the attempt by Messrs.  
5           Cavanagh and Schlegel to impose revenue decoupling on a utility that does not  
6           need it and customers that clearly do not want it.

7  
8    **LOST FIXED-COST RECOVERY VERSUS DECOUPLING**

9    **Q.     What do Mr. Cavanagh and Mr. Schlegel recommend with respect to the**  
10   **Lost Fixed Cost Recovery (“LFCR”) mechanism proposed in the**  
11   **Agreement?**

12   A.           Both Mr. Cavanagh and Mr. Schlegel recommend that the LFCR  
13           mechanism negotiated by the Stipulating Parties be rejected in favor of full  
14           revenue decoupling.

15   **Q.     What is your response to their position?**

16   A.           APS is required to meet a Commission-mandated energy-efficiency  
17           standard. The stated objective of revenue decoupling is to remove a utility’s  
18           financial disincentive to support energy efficiency, and by extension,  
19           Commission-required energy efficiency requirements. Through its support of the  
20           Settlement Agreement, APS has concluded that the combination of LFCR  
21           mechanism and rate design improvements in the Agreement sufficiently removes  
22           the Company’s financial disincentives to meet the Commission’s standards.<sup>1</sup> By  
23           itself, this is sufficient grounds to refrain from imposing decoupling: if the entity

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<sup>1</sup> See for example, direct settlement testimony of Leland R. Snook, pp. 3-7.



1       that decoupling is intended to “protect” concludes that decoupling is not  
2       necessary, there is no good reason to impose decoupling against the will of  
3       customers.

4               Representatives of a wide spectrum of customer interests – from small  
5       customers to large customers – RUCO, AARP, and AECC – and individual  
6       customers such as FEA, Kroger, and Wal-Mart – have each opposed the full  
7       revenue decoupling advocated by Messrs. Cavanagh and Schlegel. These  
8       customer groups have signed on in support of the LFCR/Rate Design alternative  
9       that was largely advanced by Staff in its direct testimony and more fully  
10      developed in the negotiated Agreement.

11             Revenue decoupling is not an end in itself. Just the opposite is true:  
12      revenue decoupling is intended to address a very specific problem – utility  
13      financial disincentives – and winds up capturing many unrelated effects, such as  
14      weather, economic conditions, and changes in customer class composition. If the  
15      specific problem that revenue decoupling is intended to address is adequately  
16      addressed through an alternative approach – and the utility, its customers, and the  
17      regulatory Staff agree on that alternative approach – then the overly-broad and  
18      widely-opposed decoupling mechanism should certainly be avoided.

19             Both Mr. Cavanagh and Mr. Schlegel appear to be second-guessing APS’s  
20      assessment that the Company does not need the added revenue protection of full  
21      decoupling to comply with the Commission’s Rules on energy efficiency. For  
22      example, Mr. Cavanagh expresses concern that the “Settlement Agreement does  
23      not make APS whole for lost fixed costs even from those sales that APS is judged

1 to have lost as a result of its programs.”<sup>2</sup> In my experience, APS is fully capable  
2 of assessing its own best interests. I believe it would be unwise for the  
3 Commission to override the Settlement Agreement in favor of Mr. Cavanagh’s  
4 and Mr. Schlegel’s insistence that APS be afforded protections it does not need  
5 and which customers do not wish to extend.

6 **Q. On page 7 of his testimony partially opposing the Settlement, Mr. Cavanagh**  
7 **indicates his opposition to addressing utility financial disincentives through**  
8 **rate design. How do you respond?**

9 A. Mr. Cavanagh is critical of the residential “opt out” proposal which would  
10 grant residential customers the freedom to choose an alternative rate design. He is  
11 also critical of utilizing rate design to exclude large General Service customers  
12 from the LFCR mechanism, complaining that “the Proposed Settlement proposes  
13 the same kind of rate design change for large customers as a rationale for  
14 excusing them from contributing to the lost fixed-cost recovery mechanism.” In  
15 making this statement, Mr. Cavanagh misapprehends the role of rate design in  
16 resolving the utility’s financial disincentive that is at the center of the decoupling  
17 debate: when fixed costs are removed from the volumetric energy charge through  
18 rate design, *there is no extra contribution to fixed-cost recovery that needs to be*  
19 *made.* Mr. Cavanagh’s inference that larger customers would somehow be  
20 “excused” from making a contribution to fixed cost recovery is groundless.  
21 Rather, Mr. Cavanagh appears to have lost touch with the goal of removing the  
22 utility’s financial disincentives to support energy efficiency – which the

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<sup>2</sup> Testimony of Ralph Cavanagh in Partial Opposition to the Proposed Settlement Agreement, p. 8, lines 1-3.

1 Settlement “opt out” and rate design for larger customers accomplish – in favor of  
2 advocacy for decoupling as an end in itself.

3 **Q. On pages 3-4 of his testimony, Mr. Cavanagh is critical of opponents of**  
4 **decoupling for ignoring the Commission’s Policy Statement on Decoupling.**  
5 **How do you respond to this criticism?**

6 A. In my direct testimony I not only referenced the Commission’s Policy  
7 Statement on Decoupling, I quoted from it – Policy Statement 11 to be exact,  
8 which provides that:

9 Broad participation in decoupling is preferred; however, the unique characteristics  
10 of each utility may merit different treatment of some customer classes. Utilities  
11 should address any proposed distinct treatments and justify why certain customer  
12 classes may merit different treatment.  
13

14 This is a section of the Policy Statement that Mr. Cavanagh overlooks in his  
15 criticism of the Settlement Agreement’s use of rate design to resolve the issue of  
16 utility financial disincentives. The Commission’s Policy Statement clearly  
17 provides the flexibility to develop a rate design approach for addressing utility  
18 financial disincentives, as the Stipulating Parties have done.  
19

20 **RESPONSE TO ADDITIONAL ISSUES RAISED BY MR. SCHLEGEL**

21 **Q. On pages 6 and 7 of his Settlement testimony, Mr. Schlegel recommends that**  
22 **the proposed four-year rate case stay out be shortened to three years. What**  
23 **is your response to this recommended change?**

24 A. I strongly oppose this proposed change. The rate case stay-out is an  
25 unequivocal benefit to customers and a major achievement of the negotiated  
26 Agreement. Shortening it is certain to bring higher rates sooner to Arizona

1 customers and would deprive customers of the full benefit of their bargain in this  
2 Agreement.

3 **Q. On page 10 of his testimony, Mr. Schlegel proposes to shift \$70 million in**  
4 **DSM funding from the DSM Adjustor to base rates. Do you support this**  
5 **change?**

6 A. Absolutely not. Not only is this change contrary to the Settlement  
7 Agreement, such a shift would reduce the visibility of the DSM program costs by  
8 burying them in base rates. Healthy public discourse on the size of the funding  
9 requirements for these programs is better assured if the cost recovery is  
10 transparent and fully disclosed in the DSM Adjustor rate.

11 **Q. In summary, do you support any of the changes to the Settlement Agreement**  
12 **advocated by Mr. Schlegel and Mr. Cavanagh?**

13 A. No, I do not.

14 **Q. Does this conclude your responsive testimony?**

15 A. Yes, it does.